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United States General Accounting Office

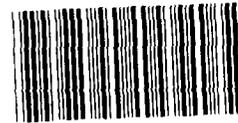
GAO

Report to Congressional Requesters

March 1988

INTERNAL CONTROLS

Status of Army Efforts to Control Contractor Access to the DOD Supply System



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541540/135616



United States
General Accounting Office
Washington, D.C. 20548

National Security and
International Affairs Division

B-222859

March 11, 1988

The Honorable Pete Wilson
United States Senate

The Honorable John Glenn
Chairman, Committee on
Governmental Affairs
United States Senate

As requested in Senator Wilson's letter of April 15, 1986, we reviewed the Army's controls over contractor access to the DOD supply system. This report is one in a series of reports related to the effectiveness of defense logistics.

As arranged with your offices, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from its issue date. At that time, we will send copies to interested committees and other members of Congress; the Secretaries of Defense and the Army; and the Director, Office of Management and Budget. Copies will also be made available to other parties upon request.

Frank C. Conahan
Assistant Comptroller General

Executive Summary

Purpose

Each year the Department of Defense (DOD) provides billions of dollars in material from its supply system to a large number of contractors to produce items, maintain them, or provide various services for the Armed Forces. Because contractors have had almost unlimited access to DOD's supply system in the past, Senator Pete Wilson and Senator John Glenn, Chairman, Senate Committee on Governmental Affairs, requested that GAO review DOD and military service policies, procedures, and practices for controlling this material. GAO's review focused on the

- status of the Army's efforts to better control contractor access to DOD supply systems and
- adequacy of the Army's financial accountability for government-furnished material (GFM).

GAO is separately reviewing Navy and Air Force controls over and accountability for GFM.

Background

GFM includes parts; assemblies; raw and processed materials used in research, development, production, maintenance, and repair of final products such as tanks, aircraft, and ships. GFM is also used in support of various services provided by contractors to military installations.

Under the Federal Acquisition Regulation, contractors are generally required to provide such material to complete a product and fulfill their contracts; however, the government provides GFM when it is considered to be in its best interest. GFM is provided without cost and is not included in the contract price. As of September 30, 1980, DOD estimated that U.S. Army contractors held about \$1.1 billion in GFM.

The Army allows contractors to obtain GFM by accessing the DOD supply system directly, ordering from base supply activities, or buying from commercial sources with Army funds. Since the 1970s, GAO and DOD have reported significant problems in the Army's management and control of GFM. As a result of House Appropriations Committee hearings, DOD directed the services in 1981 to establish one or more Management Control Activities (MCAs) to maintain central control over all maintenance contractors' access to the DOD supply system by reviewing, validating, and approving requests for GFM. In March 1986, DOD expanded the MCA concept to include production, research and development, and service contracts. The GAO review focused on maintenance and service contracts.

Results in Brief

The Army has made little progress in implementing the management control and reporting systems that DOD requires to adequately control GFM provided to contractors. Also, the Army has not yet developed a GFM accounting system that would provide an independent means of identifying how much GFM the contractors have on hand and receive annually and how it is being used. These control weaknesses offer the potential for fraud, waste, and abuse of GFM.

GAO's Analysis

In March 1981, DOD directed the services to establish MCAs to provide better management control and reporting systems pertaining to maintenance contractors' access to DOD supply systems. DOD expected the services to implement the MCA concept by November 1982; however, the Army does not project implementation of the concept until June 1989. Also, Army accounting systems do not adequately identify or control the total amount of GFM provided to contractors. The Army plans to improve its accounting systems and integrate them with the MCA concept by June 1989. According to Army officials, one of the reasons for these delays was that the Army did not have the data base necessary to implement the required MCA controls on a system-wide basis. Another reason was that a lack of resources has slowed implementation of the control system intended to identify contracts authorizing GFM and to validate and approve requisitions prior to processing.

In March 1986, DOD expanded the scope of the MCA directive to include screening GFM requests for all types of contracts, not only maintenance contracts, awarded centrally as well as at the base (retail) level. The Army initiated a study in April 1987 to determine the feasibility of establishing MCA controls at the base level, and expects to develop a strategy to implement the study's recommendations later this year.

Even after MCAs have been established at the base level, GFM requisitions will bypass MCA controls unless the Army effectively implements its recent policy prohibiting contractors from using military codes to order GFM. In the past, the Army has allowed contractors to use military instead of contractor codes, which has, in effect, given them almost uncontrolled access to the DOD supply system.

Recommendation

Over 6 years have passed since DOD required better controls over contractor access to the DOD supply system. Therefore, GAO recommends that the Secretary of the Army give priority to developing a plan of

action with firm milestones for implementing effective controls over material furnished to contractors by the government.

Agency Comments and Our Evaluation

DOD agreed with GAO's findings and the recommendation. DOD stated that the Army has not been as aggressive as it should have been to implement existing DOD policies with respect to instituting controls over material provided to contractors. It noted, however, that the Army has developed an action plan that should result in stronger controls.

DOD also noted that, with one exception, none of the internal control weaknesses associated with the problem of controls over GFM were identified by the Army commands and installations visited by GAO. The Army will consider reporting contractor access to GFM as an internal weakness in future reports required by the Federal Managers' Financial Integrity Act of 1982.

Contents

Executive Summary		2
Chapter 1		8
Introduction	Government-Furnished Material	8
	Historical Problems in Managing and Controlling Government-Furnished Material	10
	Objectives, Scope, and Methodology	11
Chapter 2		13
Status of Army's Efforts to Establish Better Controls Over Contractors' Access to DOD Supply Systems	Management Control Activities as Envisioned by DOD Have Not Been Implemented	14
	Retail-Level GFM Controls	15
	Contractors' Use of Army Unit Codes to Requisition GFM	17
	Other Changes in DODAAC Procedures	18
	Financial Accountability for GFM	19
	Conclusions	21
	Recommendation	21
	Agency Comments and Our Evaluation	21
Appendixes	Appendix I: GFM Provided to Contractors	24
	Appendix II: Letter From the Deputy Assistant Secretary of Defense (Systems)	25

Abbreviations

AMC	Army Materiel Command
AMCCOM	U.S. Army Armaments, Munitions, and Chemical Command
AVSCOM	U.S. Army Aviation Systems Command
DAAS	Defense Automatic Addressing System
DOD	Department of Defense
DODAAC	Department of Defense Activity Addressing Code
DODI	Department of Defense Instruction
FAR	Federal Acquisition Regulation
FORSCOM	U.S. Army Forces Command
GFM	Government-Furnished Material
LSSA	Logistical Systems Support Activity
MCA	Management Control Activity
MICOM	U.S. Army Missile Command
MILSTRIP	Military Standard Requisitioning and Issue Procedures
TRADOC	U.S. Army Training and Doctrine Command
TROSCOM	U.S. Army Troop Support Command

Introduction

On May 23, 1986, we issued a report on problems we had identified in Department of Defense (DOD) inventory management practices.¹ As a result of that report, Senator Pete Wilson, then Chairman of the Senate Armed Services Committee's Task Force on Inventory Management, requested that we conduct the additional audit work necessary to identify the magnitude of those problems. Subsequently, Senator John Glenn, Chairman, Senate Committee on Governmental Affairs, joined the request.

One of the problems involved the control over contractor access to the DOD supply system. The concern over adequacy of controls arose because of the large number of contractors having access to the system in order to obtain government-furnished material (GFM).

Government-Furnished Material

GFM is property that may be incorporated into or attached to a deliverable end item or that may be expended or consumed in performing a contract. GFM includes parts, components, assemblies, raw and processed materials used in the research, development, production, maintenance and repair, and servicing of such final products as tanks, aircraft, and ships. Since, with few exceptions, GFM is provided without cost to contractors, it is not usually included in the contract price. Once issued to a contractor, GFM is generally dropped from government-maintained inventory records, and the contractor becomes responsible for maintaining the government's accountable records for the material in its possession. Although the total amount of GFM currently in the hands of contractors is unknown, the most recent available DOD data (September 30, 1980) showed that it was about \$14 billion.² Over \$1.1 billion of that total was associated with Army contractors.

Federal and Defense Acquisition Regulations authorize GFM to be provided to contractors when it is determined to be in the best interest of the government for reasons of economy, standardization, production

¹Inventory Management: Problems in Accountability and Security of DOD Supply Inventories (NSIAD-86-106BR, May 1986).

²We testified on March 6, 1985, in a hearing before the House Committee on Government Operations that this figure was probably understated. On February 6, 1987, we asked DOD for an update of this figure. However, on April 9, 1987, DOD replied that while such data had not been collected by DOD and the services, actions were underway to do so. In February 1988, DOD provided us with its results. DOD estimated that as of September 30, 1986, the DOD total had grown to about \$16.1 billion and the Army total to about \$2.4 billion. DOD also informed us that the totals included material acquired by contractors from commercial sources with government funds.

expediency, and other appropriate circumstances. The regulations, however, state that maximum reliance is to be placed on contractors to provide all material necessary to accomplish government contracts.

GFM is requisitioned, issued, and received pursuant to procedures outlined in MILSTRIP manual 4140.17-M and Army Regulation 725-50. Army contractors can send GFM requisitions directly to wholesale inventory control points or route them through the Defense Automatic Addressing System (DAAS) over the automatic digital network. Manual requisitions bypass DAAS and generally go directly to the wholesale inventory control points. Contractors can also obtain materials by (1) ordering from retail-level base supply activities, which replenish their stocks from the wholesale level inventories or, (2) buying from commercial sources.³

A DOD Activity Address Code (DODAAC) is assigned to contractors that need to receive GFM. DODAACs have service code prefixes indicating where the requisition originates—whether from one of the services, the Defense Logistics Agency, the General Services Administration, or a contractor. As of July 1987, the Army had over 2,000 DODAACs assigned to contractors.

The Army's wholesale inventory control points are located at six commodity commands under the Army Materiel Command (AMC). Requisitions received from contractors or Army units are processed by an automated system called the Commodity Command Standard System. The six AMC commodity commands are the

- U.S. Army Aviation Systems Command, St. Louis, Missouri;
- U.S. Army Missile Command, Redstone Arsenal, Alabama;
- U.S. Army Communications-Electronics Command, Fort Monmouth, New Jersey;
- U.S. Army Troop Support Command, St. Louis, Missouri;
- U.S. Army Tank-Automotive Command, Warren, Michigan; and
- U.S. Army Armament, Munitions, and Chemical Command, Rock Island, Illinois.

³For purposes of this report, wholesale-level inventories refer to materials stored by inventory control points and depots for distribution to retail-level activities, such as posts, stations, and installations. They include materials managed by all the military departments as well as the Defense Logistics Agency and the General Services Administration.

Historical Problems in Managing and Controlling Government- Furnished Material

During the 1970s, we and the DOD audit agencies reported that DOD and the military services had not effectively implemented the government's policy of relying on contractors to provide as much material as possible and that contractors were able to requisition billions of dollars annually from DOD supply activities. One 1978 Defense Audit Service report concluded that this practice had resulted in widespread excessive and uneconomical requisitioning, abuse of transportation priority designators, unauthorized use of GFM, and lack of control over GFM after it was issued to contractors.⁴

During fiscal year 1979 and 1980 House Appropriation Committee hearings on DOD appropriations and a subsequent hearing by the House Committee on Government Operations, GFM problems were extensively discussed. The hearings resulted in a series of committee recommendations, including one that DOD should develop a plan of action as soon as possible to install adequate controls over GFM.

In response to this recommendation, DOD issued an instruction (DODI 4140.48) in 1981 entitled "Control of Access to DOD Material Inventories by Maintenance Contractors," which directed each service to establish Management Control Activities (MCAs) to maintain control over maintenance contractors' access to DOD supply systems by ensuring that only authorized material was provided under the terms of the contract. To accomplish this control, each MCA was to identify all maintenance contracts authorizing GFM and to validate and approve contractor requisitions prior to processing. The Army issued implementing procedures for the DOD instruction by adding chapter 17 to Army Regulation 725-50 on October 1, 1982. The regulation required the establishment of a MCA at each of AMC's commodity commands which authorized the use of GFM by contractors.

Following an additional hearing by the House Committee on Government Operations in March 1985 on GFM provided to defense contractors, the May 1985 Committee report (No. 99-139) entitled "Costly Failure to Control Government Property Furnished to Contractors Remains Uncorrected" recommended among other things that (1) DOD efforts to install appropriate accounting controls over GFM be speeded up, and (2) plans for implementing the MCA concepts contained in DODI 4140.48 be expedited, and the control requirements extended to production and supply contractors.

⁴Administration of Maintenance, Overhaul, and Repair Contracts (Report No. 890, May 1978).

In March 1986, the DOD instruction was extended to cover all types of contracts, such as service, production, and research and development contracts for both base and centrally awarded contracts. DOD plans to implement the new instruction in phases, starting with maintenance and production contracts awarded at the wholesale level—inventory control points and depots—before going on to service contracts awarded at the retail level—units post, camps, stations, and installations. The Army's implementing procedures are being revised to incorporate these changes.

Objectives, Scope, and Methodology

Our objectives were to determine whether the Army has (1) implemented procedures to ensure that contractors obtain from the supply system only the material they need to fulfill the provisions of their contracts and (2) adequate financial accountability for GFM. To accomplish our objectives, we did work between June 1986 and July 1987 at the following locations:

U.S. Army

- Headquarters, Department of the Army, Pentagon;
- Training and Doctrine Command, Ft. Monroe, Virginia;
- Forces Command, Ft. McPherson, Georgia;
- Army Materiel Command, Alexandria, Virginia;
- Aviation Systems Command, St. Louis, Missouri;
- Missile Command, Redstone Arsenal, Alabama;
- Strategic Defense Command, Huntsville, Alabama;
- Ft. Rucker, Alabama; and
- Ft. Riley, Kansas.

Contractors

- Grumman Aerospace Corporation, Stuart, Florida;
- Sikorsky Support Services, Inc., Ft. Rucker, Alabama;
- E C Services Co., Ft. Riley, Kansas;
- Doss Aviation Inc., Ft. Riley, Kansas.

At present, the Army does not have a management information system that identifies contracts that include a provision for GFM, with the amount of GFM to be provided. Therefore, our work was directed primarily at reviewing controls for ensuring that contractors are allowed to obtain only the GFM needed to fulfill contract obligations. Our work included (1) reviewing and evaluating instructions, procedures, and regulations relating to GFM; (2) conducting interviews with supply, contract, budget, and accounting officials; and (3) reviewing selected wholesale

and retail contracts to illustrate the conditions under which maintenance contractors are obtaining GFM.

We performed a major portion of our review at the Aviation Systems Command (AVSCOM) because Army officials advised us that AVSCOM generally processed more GFM requisitions than the other wholesale inventory control points. Since the Army had no centralized data base on contracts providing for GFM, we reviewed selected AVSCOM-awarded contracts that contained provisions for GFM to illustrate the conditions under which material can be obtained from DOD's supply systems.

We visited the Forces Command (FORSCOM) and Training and Doctrine Command (TRADOC) headquarters to obtain information on contractors using GFM in performance of their contracts at the base level. To understand how GFM is managed at the base level, we visited a TRADOC base, Fort Rucker, and a FORSCOM base, Fort Riley, and reviewed the largest contracts providing for GFM. We used the contracts as case studies to allow us to describe the conditions under which a contractor obtains GFM. Our work was performed in accordance with generally accepted government auditing standards.

Status of Army's Efforts to Establish Better Controls Over Contractors' Access to DOD Supply Systems

The Army does not have in place the management control and reporting systems that DOD requires to adequately control GFM provided to contractors. DOD issued the initial instruction requiring all services to establish MCAs to control GFM provided to maintenance contractors in March 1981 and expected implementation by November 1982. An Army project started in 1985 to integrate the MCA requirements into the existing requisition processing system was still under development and testing in June 1987. According to Army officials, reasons for the delay included the lack of a data base to implement required MCA controls on a system-wide basis and unavailability of resources necessary to establish and maintain the MCAs. The Army now projects implementation of the MCAs by June 1989.

DOD revised its instruction in March 1986, expanding its scope to include the screening of material requests from all types of contractors, such as production, research and development, and service contractors. Our review of selected contracts involving GFM awarded by retail-level installations showed that the installations had varying controls over the GFM, but none provided the controls envisioned by the DOD instruction. In April 1987, the Army tasked its Logistics Evaluation Agency to study the feasibility of implementing the MCA concept at the retail level, and expects to develop a strategy to implement the study's recommendation during the third quarter of fiscal year 1988.

We also found that existing Army accounting systems do not provide adequate identification or control of the total amount of GFM provided to contractors. The Army has recognized that a better financial accounting system for GFM is needed and that this system should be integrated with the MCA concept. These efforts are projected to be completed by June 1989.

Finally, we found that Army contractors are permitted to requisition GFM from the DOD supply system without being identified as contractors, as required by regulations. As a result, their GFM requisitions are treated as if they were from an Army unit. Even after MCAs are established by the Army at both the wholesale and retail levels, GFM requisitions would continue to bypass MCA controls unless the Army effectively implements a recently announced policy to discontinue contractors' use of military unit identification codes.

Management Control Activities as Envisioned by DOD Have Not Been Implemented

The Army has not established MCA controls, as required by the 1981 DOD Instruction 4140.48 and implementing Army regulation, principally because it has not completed development of the automated system needed to implement such controls. DOD expected the controls to be in place by November 1982.

The instruction required each DOD component to establish MCAs with management reporting systems to

- screen all contractor requisitions by specific stock number or stock class for validation and approval;
- reject all requisitions that do not comply with contract terms;
- pass approved requisitions to appropriate DOD sources for supply action;
- maintain a contract, requisition, and shipment status history file that serves as an auditable record of GFM transactions;
- provide DOD contract administration offices a quarterly report of material shipments and the number of requisitions rejected; and
- provide the Assistant Secretary of the Defense for Acquisition and Logistics a status report that reflects the number and dollar value of requisitions from assets in long supply, i.e., assets that exceed known requirements.

Recognizing that it did not have the data base to implement the required MCA controls on a system-wide basis, AMC, in early 1982, instructed its six commodity commands to limit validation of GFM requisitioning to items managed by the command that awarded the contract.

The commodity commands attempted in various ways to comply with the different MCA instructions which, in some cases, resulted in problems. For example, both the U.S. Army Aviation and Missile Commands established MCAs based on the AMC guidance, while the U.S. Army Armaments, Munitions, and Chemical Command (AMCCOM) tried to follow the DOD instruction and implementing Army regulation. In one instance, this resulted in AMCCOM cancelling contractor requisitions submitted by AVSCOM because they were not processed according to the Army regulation (AR 725-50), which required screening of all GFM requisitions.¹ To address the continuing need for MCA control requirements for processing GFM requisitions, AMC tasked AVSCOM in August 1985 to take the lead in developing an automated system for implementing the MCA controls for

¹At that time, AVSCOM was part of the U.S. Troop Support and Aviation Readiness Command.

use at the wholesale commodity commands. Since then, numerous conferences have been held with representatives from the commodity commands and other interested Army units. The system was still being developed and tested as of June 1987. In March 1987, Army officials advised DOD that the MCA concept would be implemented by May 1988, but according to DOD's comments to our draft report, the date has slipped to June 1989.

According to Army officials, contributing factors that slowed MCA implementation were limited coordination between Army organizations involved in supply and contracting and a lack of resources thought necessary to establish and maintain MCAs.

In its response to our draft report, DOD agreed that the MCAs, as envisioned by DOD Instruction 4140.48, have not been fully implemented by the Army. It noted that the Army has efforts underway to fully implement/automate the MCA concept within the Army Materiel Command. These actions are being directed within current resource levels and coordinated between supply and contracting organizations. The actions are expected to be completed by June 1989.

Retail-Level GFM Controls

The March 6, 1986, revision of the DOD instruction expanded its scope to include the screening of material requests from all types of contractors, including production, research and development, and service contractors. DOD expected the services to implement the revised instruction in phases, starting with research and development and production contracts awarded at the wholesale level before going to retail-level contracts.

At the FORSCOM and TRADOC headquarters, we asked for a list of contracts with GFM awarded by these commands and their installations. Neither had such information or reporting systems for collecting data on GFM provided to contractors. To obtain this type of data, we asked the commands to contact each of their subordinate installations. Eleven bases reported that they had a total of 15 contracts authorizing GFM. Some of the bases reported fiscal year 1986 amounts of GFM provided under the contracts, while others reported the value of GFM the contractors had on hand. The reported data indicates that some of the contractors are being provided significant amounts of GFM, as shown in appendix I.

To determine what controls exist to monitor and approve issuance of GFM at the retail level, we visited two installations—a TRADOC base, Fort

Rucker, Alabama, and a FORSCOM base, Fort Riley, Kansas. These installations had varying controls over GFM authorized by maintenance contracts, but none provided controls envisioned by the DOD instruction. The Army tasked its Logistics Evaluation Agency in April 1987 to study the feasibility of implementing the MCA concept at the retail level. In commenting on our draft report, DOD stated the Army expects to develop a strategy to implement the study recommendations during the third quarter of fiscal year 1988.

Fort Riley

At Fort Riley, Kansas, home of the 1st Infantry Division and several other smaller tenants, we examined the two largest equipment maintenance contracts: one with E C Services for maintenance of combat vehicles and one with Doss Aviation for aircraft maintenance. The Chief of the Resource Management Division, Directorate of Logistics, who is responsible for monitoring the stock control, property accountability and maintenance functions of contractors, estimated that during fiscal year 1986, E C Services obtained about \$4 million in GFM and Doss Aviation obtained about \$560,000 in GFM.

Neither E C Services nor Doss Aviation has authority to requisition GFM directly from the DOD wholesale supply system. Instead, they submit their GFM requisitions for repair parts to the base supply unit. One supply technician in the Directorate of Logistics reviews all repair part requisitions from both contractors—more than 500 on some days. The review essentially consists of checking the requisitions for completeness and correctness of format. The technician does not use available maintenance manuals for the end items and components to determine whether the requested items are the type the contractor should be requisitioning. To the extent he evaluates the appropriateness of the requisitions, he relies solely on his 15 years of experience. The technician's review is the only review before the GFM requisitions are passed on to a wholesale-level source of supply (inventory control point) to be filled.

Fort Rucker

At Fort Rucker, Alabama, we reviewed the installation's 5-year, cost-plus-incentive fee contract with Sikorsky Support Services, Inc., which performs all maintenance at the unit, intermediate, and limited depot level as well as scheduled inspections on helicopters and fixed-wing aircraft at Fort Rucker. As of April 1987, the contractor had \$26 million of

GFM on hand. The total value of GFM provided to the contractor from September 1984 through April 1987 was \$46.2 million.²

The contract provides that the government furnish all materials, supplies, equipment, machinery, tools (excluding mechanics' hand tools) necessary for the completion of the work described in the contract's performance work statement. It does not contain a list of items and corresponding quantities that the contractor is authorized to requisition.

The contractor obtains GFM items directly from the DOD supply systems, as well as through reimbursable and government local purchase requisitions and the Fort Rucker Self-Service Supply Center. None of these requisitioning methods provide for any review of the appropriateness of the items and quantities involved.

Contractors' Use of Army Unit Codes to Requisition GFM

DOD's Directive 4000.25-D and Military Standard Requisitioning and Issue Procedures (MILSTRIP) Manual DOD 4140.17-M require DOD components to assign DOD Activity Address Codes (DODAACS) to all in-house activities as well as to all commercial organizations that have material and service contracts with them to facilitate the requisitioning, shipping, and billing of supplies. In-house Army activities are to be identified by DODAACS preceded by an Army-unit service code, while contractors are to be assigned DODAACS preceded by a contractor service code.

We found that Army contractors were permitted to requisition GFM from the DOD supply system without being identified as contractors. As a result, their GFM requisitions are treated as if they were from an Army unit, and they bypass GFM control checks and edits. Even after the Army establishes MCAs at both the wholesale and retail level, these requisitions would continue to bypass future MCA controls unless existing regulations are enforced.

On the 15 contracts awarded by 11 FORSCOM and TRADOC installations previously mentioned, 42 of 45 DODAACS used to requisition GFM contained an Army-unit service code prefix instead of a contractor DODAAC. The amount of GFM provided or reported as on hand to support 14 of the 15 contracts was in the tens of millions of dollars, as shown in appendix I.

²This total is only for material funded through the Operation and Maintenance, Army, appropriations account. We could not determine the amount of GFM funded by the Other Procurement, Army, account because all material and equipment purchases out of that account were combined at Fort Rucker. For fiscal year 1986, the combined total was estimated to be \$236 million.

When made aware of the contractors' improper use of Army-unit DODAACs, the Logistical Systems Support Activity (LSSA) asked the Army commands on March 13, 1987, to require all contractors to use contractor DODAACs when requisitioning GFM and to prohibit them from using Army-unit DODAACs. Some of the Army commands questioned the LSSA requirement, because it seemed to require the assignment of a contractor DODAAC to contractors who operate base supply offices at Army installations. (Such offices do not use GFM.) To clarify this and other DODAAC-related issues, the Department of the Army requested AMC to host a policy meeting with the major Army commands and activities. During the meeting at AMC in May 1987, it was agreed that any retail contractor performing work at retail installations would be given contractor DODAACs if the contractor performs (1) work which consumes GFM and (2) services that require access to the government supply system. This policy was issued to all major Army commands and activities by the Department of the Army messages dated August and September 1987.

Other Changes in DODAAC Procedures

To further limit current contractor and service unit access to the DOD supply system and enhance future MCA control of GFM requisitions, the Army, in recent years, has made some additional and proposed other changes to DODAAC procedures, as briefly described:

- In January 1986, LSSA required AMC commodity commands to ship all GFM only to authorized addresses (those in the DODAAC directory), except when required as a result of a natural disaster or a national emergency. The purpose of this change was to reduce opportunities for fraud and abuse like a case we highlighted in our May 1986 report on inventory management in which an Army security team in 1985 penetrated the supply system at an Army depot and had items shipped to an unauthorized address.

LSSA modified this requirement in March 1986 to include additional exceptions, such as for sales, donations, loans, and issues of Army material to qualifying federal, state, and civil organizations. However, AVSCOM officials told us that they continue to send material only to addresses in the directory, even though there is no longer a requirement to do so.

In October 1986, the Defense Logistics Standard Systems Office proposed a change to the MILSTRIP system to restrict (for requisitioning activities) and to eliminate (for contractors) the shipment of GFM to addresses not listed in the DODAAC directory. The rationale for the proposed change was that reviews of the requisitioning processes had

revealed that customers with a knowledge of the requisitioning procedures could order material under a valid DODAAC and divert shipment to an unauthorized third-party address. The Defense Logistics Standard Systems Office is revising this proposal to permit the shipment of GFM to addresses not in the directory in certain situations, such as in a national emergency or for natural disasters.

- LSSA has started assigning separate DODAACS to each contract (as required in chapter 9 of Army Regulation 725-50, dated October 1, 1986). Previously, a contractor was assigned one DODAAC, which could be used to requisition GFM for more than one contract. The purpose of this new method of assigning DODAACS to contractors is to ensure that GFM requisitions are not filled after a contract is completed. Under the new method, the MILSTRIP system will send GFM to a contractor only between the effective date and expiration date of the contract, unless the contract period is extended.

When a contractor is working at more than one location under the same contract, a DODAAC will be required for each location because only one shipping address can be assigned to a DODAAC.

- In October 1985, AMC prohibited commodity commands and depots from establishing authorized requisitioner and shipping addresses and noted that decentralized control of DODAAC files presented the opportunity for fraud in that GFM could be shipped to unauthorized activities. AMC directed LSSA to approve all changes to the directory. According to AVSCOM officials, AMC's directive has been implemented and changes can no longer be made to the directory without LSSA's approval.

Financial Accountability for GFM

Since 1967, we, the Joint Economic Committee, and the House Government Operations Committee have raised concerns about the financial accountability for GFM provided to contractors. DOD and the services were criticized because they (1) had not established independent controls to provide accountability over GFM from receipt by a contractor to use on a contract or return to DOD and (2) had not adequately accounted for the quantity and value of GFM provided to contractors as required by the National Security Act of 1947, as amended. We recommended in two reports³ that DOD and the services establish systems that adequately

³Need for Improvements in Controls Over Government-Owned Property in Contractors' Plants (B-140389, Nov. 1967) and Weaknesses in Accounting for Government-Furnished Materials at Defense Contractors' Plants Lead to Excesses (FGMSD-80-67, Aug. 1980).

account for GFM by quantity and value and also report contractors' use of it. We believed that information from these systems would give government officials independent data to judge whether contractor records, which are now the government's accountable GFM records, conform with the FAR.

DOD concurred with our recommendations and between 1981 and 1983 established general accounting principles and standards for GFM and directed the services to develop and implement accounting systems that conform with the Comptroller General's accounting principles, standards, and other related requirements. However, according to the DOD fiscal year 1986 report to Congress on its progress to meet the objectives of the 1982 Federal Managers' Financial Integrity Act, none the services had met this requirement. Consequently, the Army currently does not have an independent means to identify how much GFM is in the hands of its contractors, how much is being provided annually, and how it is being used.

The Army has recognized that a better financial accounting system for GFM is needed and that this system should be integrated with the MCA concept and the AMC's Commodity Command Standard System for material requisitioning. An Army project to do this was underway and, at the time of our audit work, was targeted to be implemented within AMC's commodity commands by September 1988. In its comments on our draft report, DOD stated this date has slipped to June 1989.

We endorse the Army's efforts to implement a GFM financial accounting system, but we are concerned about the uncertain implementation date. According to the Chief of AMC's Policy and Procedures Branch, Finance and Accounting Division, the implementation date depends on when the MCAs at the commodity commands become operational.

In commenting on our draft report, DOD also noted that the Army has not yet determined what method of GFM accounting will be used at retail-level installations. According to DOD, the exact method will be determined after the Army has completed its study on how to implement the MCA concept at the retail level. The Army projects that the conceptual approach and milestones for implementing the GFM retail-level accounting system will be completed during the third quarter of fiscal year 1988.

Conclusions

Although over 6 years have passed since DOD issued its initial instruction to establish MCAS to provide central control over GFM provided to maintenance contractors, the Army has not yet implemented the instruction. A project to develop the automated system necessary for implementation has been under development since August 1985. The Army is also performing a feasibility study to determine the best approach for establishing MCA-type controls over GFM issued to contractors at the retail level.

However, the benefits of the MCA concept will be adversely affected if the Army does not effectively implement its recently announced policy that all contractors receiving GFM be specifically identified as such rather than as military units, which allows GFM requisitions to bypass GFM controls.

The Army has not yet developed and implemented a GFM accounting system that provides an independent means of identifying how much GFM is in the possession of contractors, how much is being provided annually, and how it is being used. This situation will not be corrected until MCAS become operational and start providing the reports specified in the DOD instruction.

Recommendation

Since over 6 years have passed since DOD required better controls over contractor access to the DOD supply system, we recommend that the Secretary of the Army give priority to developing a plan of action with firm milestones for implementing the needed controls.

Agency Comments and Our Evaluation

DOD agreed with our findings and our recommendation and described Army actions to address them. DOD stated that the Army has not been as aggressive as it should have been in implementing existing DOD policies on instituting controls of GFM provided to contractors.

DOD also noted that none of the GFM internal control weaknesses had been identified by the Army commands and installations that we visited, except for the Army Materiel Command. AMC had identified this area as an internal control weakness since January 1985. The Army is now considering identifying this area as a continuing control weakness in future assurance statements, which are required by the Federal Managers' Financial Integrity Act of 1982.

DOD stated that the Army will give priority to developing a plan of action with milestones for implementing controls over contractor access

Chapter 2
Status of Army's Efforts to Establish Better
Controls Over Contractors' Access to DOD
Supply Systems

to the DOD supply system. It noted that the Army is proceeding to implement the MCA concept at both the wholesale and retail level. Implementation of the concept at the wholesale level is now projected for June 1989. At the retail level, the Army projects that it will have developed a conceptual approach and implementation milestones during the third quarter of fiscal year 1988.

We believe that the Army actions, are a step in the right direction and, if implemented properly and in a timely fashion, will alleviate the long-standing problems pertaining to control over contractor access to the DOD supply system.

GFM Provided to Contractors

Dollars in thousands

Contractor	Location	GFM amount
Sikorsky Support Services, Inc.	Ft. Rucker	\$20,220 ^a
Doss Aviation, Inc.	Ft. Bliss	18 ^b
Pan American World Services, Inc.	Ft. Gordon	389 ^a
Pan American World Services, Inc.	Ft. Gordon	4,343 ^a
PRC Scientific Support World Services, Inc.	Ft. Ord	5,901 ^b
Northrop Worldwide Aircraft Service, Inc.	Ft. Eustis	132 ^b
Boeing Services, International	Ft. Irwin	8,406 ^b
E C Corporation	Ft. Riley	^c
Doss Aviation, Inc.	Ft. Riley	584 ^b
Kass Management Services	Presidio of San Francisco	40 ^b
Luzon Services	Ft. Ord	5 ^b
Luzon Services	Ft. Hunter Liggett	15 ^b
Global Associates	Ft. Clayton	128 ^b
Pan American World Services, Inc.	Ft. Bragg	37 ^b
J&J Maintenance, Inc.	Ft. Bragg	4,852 ^b

^aReported as on-hand inventory.

^bProvided during fiscal year 1986.

^cNot available

Letter From the Deputy Assistant Secretary of Defense (Systems)



ASSISTANT SECRETARY OF DEFENSE
WASHINGTON, D.C. 20301-8000

PRODUCTION AND
LOGISTICS

(L/SD)

JAN 26 1988

Mr. Frank C. Conahan
Assistant Comptroller General
National Security and International
Affairs Division
U.S. General Accounting Office
Washington, DC 20548

Dear Mr. Conahan:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) draft report, "INTERNAL CONTROLS: Status of Army Efforts To Control Contractor Access to DoD Supply System," dated November 16, 1987 (GAO Code 391569) OSD Case 7463.

The Department agrees with the draft report findings and recommendations. Unfortunately, the Army has not been as aggressive as it should have been in formally implementing Department policies with respect to instituting controls over material provided to contractors.

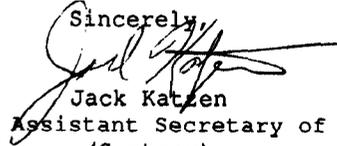
Of the Army activities visited by the GAO, only the Army Materiel Command (AMC) had identified internal control weaknesses associated with Government-furnished material (GFM) control problems. The AMC has identified contractor access to the DoD supply system as an internal control weakness since January 1985. The Army will, if appropriate, identify contractor access to GFM as an internal weakness in future assurance statements.

Although the Army has not yet achieved the degree of control over its GFM envisioned by the Department and the GAO, the Army plan of action, set forth in greater detail in the enclosed Department comments on the findings and recommendations, should result in stronger controls over GFM.

**Appendix II
Letter From the Deputy Assistant Secretary
of Defense (Systems)**

The DoD appreciates the opportunity to comment on the findings and recommendations of this draft GAO report.

Sincerely,



Jack Katzen
Deputy Assistant Secretary of Defense
(Systems)

Enclosure

DEPARTMENT OF DEFENSE COMMENTS ON
GAO DRAFT REPORT - DATED NOVEMBER 16, 1987
(GAO CODE 391569/OSD CASE 7463)

"INVENTORY CONTROLS: STATUS OF ARMY EFFORTS TO
CONTROL CONTRACTOR ACCESS TO DOD SUPPLY SYSTEM"

* * *

FINDINGS

FINDING A: Army Management Control Activities Are Not Yet Implemented. The GAO reported that, in March 1981, the DoD issued DoD Instruction 4140.48 requiring all the Services to establish management control activities (MCAs) to control Government-furnished material (GFM) provided to maintenance contractors, with implementation expected by November 1982. According to the GAO, the Army Materiel Command (AMC) recognized that it did not have the data base to implement the required MCA controls on a system-wide basis and, therefore, in early 1982, instructed its six commodity commands to limit GFM validation requisitioning to items managed by the command that awarded the contract. The GAO reported that the commodity commands attempted to comply with the MCA instructions, but encountered problems. The GAO found that, subsequently, in August 1985, the AMC tasked the Aviation Systems Command to take the lead in developing an automated system for implementing the MCA controls. The GAO observed, however, that although numerous conferences have been held, as of June 1987, the system was still being developed and tested. The GAO noted that, according to Army officials, factors slowing MCA implementation included limited coordination between Army supply and contracting organizations and a lack of sufficient resources. According to the GAO, the Army now projects implementation in May 1988. (p. 2, pp. 14-17/GAO Draft Report)

DOD RESPONSE: Concur. The Department agrees that the MCAs, as envisioned by DoD Instruction 4140.48, have not been implemented fully in the Army. All ongoing efforts to implement/automate the MCA concept within the AMC are being directed within current resource levels, and actions are being coordinated between supply and contracting organizations. Full implementation of the MCA within the AMC is scheduled for June 1989.

The Army has gained better control over contractor access to the wholesale supply system through improved management of the DoD Activity Address Code (DODAAC) system (as cited in the GAO

ENCLOSURE

Now on p. 3.
See pp. 13-15.

Appendix II
Letter From the Deputy Assistant Secretary
of Defense (Systems)

report) and implementing procedures at the commodity commands to validate incoming contractor requisitions.

FINDING B: Retail-Level GFM Controls Not Yet In Place. The GAO reported that, in March 1986, the DoD revised the MCA directive to include the screening of material requests from all types of contractors, such as production, research and development, and service contractors. According to the GAO, the DoD expected the Services to implement the revised instruction in phases, starting with contracts awarded at the wholesale level, and then going to retail-level contracts.

The GAO reported that, to determine what controls exist to monitor and approve issuance of GFM at the retail level, it visited the Army Training and Doctrine Command (TRADOC) Base at Fort Rucker and the Army Forces Command (FORSCOM) at Fort Riley. The GAO found that, while the installations had varying controls over GFM authorized by maintenance contracts, they had not established the controls envisioned by the DoD Instruction. The GAO pointed out that, in April 1987, the Army tasked the Logistics Evaluation Agency to study the feasibility of implementing the MCA concept at the retail level. The GAO noted that this study is expected to be completed by December 1987. (p. 2, pp. 18-21/GAO Draft Report)

DOD RESPONSE: Concur. The Army has not yet implemented controls over the GFM authorized by production, retail-level, research and development, and service contracts. As mentioned by the GAO, in April 1987, the Army tasked its Logistics Evaluation Agency (LEA) to study the feasibility of implementing DoD Instruction 4140.48 at the retail level. This report will be completed during the first quarter of FY 1988.

Conceptually, it is envisioned that the MCAs will be integrated into the current retail structure at major installations. Any review of retail contractor initiated requisitions will be done at that level to include automated edits and referrals. The concept will become more concrete when the LEA study is analyzed and an implementation strategy is determined. This will be accomplished during the third quarter of FY 1988.

FINDING C: Contractor Use Of Military Codes To Requisition GFM. The GAO reported that DoD procedures require that DoD Activity Address Codes be assigned to all in-house activities and commercial organizations having material and service contracts with them to facilitate the requisitioning, shipping and billing of supplies. The GAO noted that the Address Codes are to include a code identifying the entity as an Army unit or a contractor. The GAO found, however, that frequently Army contractors were permitted to requisition GFM from the DoD supply system without being identified as contractors and thus bypassed GFM control checks and edits. The GAO found that, for

Now on p. 3.
See pp. 15-17.

Appendix II
Letter From the Deputy Assistant Secretary
of Defense (Systems)

Now on p. 3.
See pp. 17-18.

the 15 FORSCOM and TRADOC contracts it reviewed, 42 of the 45 Activity Address Codes contained an Army service code, rather than a contractor code. The GAO concluded that this practice gives contractors almost uncontrolled access to the DoD supply system. While acknowledging the AMC has taken some actions to ensure that contractors are given the proper address codes, the GAO also concluded that if the Army does not effectively implement this recently announced policy, the benefits of the MCA concept will be adversely affected. (p. 3, pp. 21-23, pp. 27-28/GAO Draft Report)

DOD RESPONSE: Concur. During the timeframe of the GAO review, the Major Army Commands (MACOMs) were not fully aware of the Army policy on DODAAC assignment for a contractor. In March 1987, the Army Logistics Systems Support Activity (LSSA), the Army central service point for Department of the Defense Activity Address Codes (DODAACs), sent a message to all MACOMs requesting that all "W" coded (Army) DODAACs used by contractors performing mission functions previously handled by Government employees be deleted and that "C" coded (contractor) DODAACs be requested. During August and September 1987, Headquarters Department of the Army (HQDA) established a policy that allowed contractor-operated supply support activities and consolidated property accounts operating under the purview of a Government accountable officer to retain "W" DODAACs. Consequently, contractors that perform receipt, stock, and issue functions, and do not consume Government material, have retained a "W" coded DODAAC.

During the second quarter of FY 1988, the HQDA will reemphasize to the MACOMs the current Army policy on the assignment of contractor DODAACs at the retail level.

FINDING D: Other Changes In Activity Address Codes. The GAO reported that in recent years the Army has made some (and proposed other) changes to the Activity Address Code procedures to limit contractor and Service unit access to the DoD supply system, and to enhance control of GFM requisitions. For example, the GAO reported that, in 1986, the Army Logistics Systems Support Activity (LSSA) took action to require that the AMC ship GFM only to authorized addresses. The GAO noted that a similar procedure has been proposed by the Defense Logistics Standard Systems Office for GFM covered by the Military Standard Requisitioning and Issue Procedures system. As another example, the GAO reported that the LSSA has started assigning separate activity address codes to each contract, as required by Army regulations. The GAO noted that, previously, a contractor was assigned one address code, which could then be used for more than one contract. The GAO pointed out that the new procedure will ensure that GFM requisitions are not filled after a contract is completed. A third example cited by the GAO concerned an October 1985, AMC action to prohibit commodity

Now on pp. 18-19.

commands and depots from establishing authorized requisitioner and shipping addresses. In addition, the GAO noted that the AMC directed the LSSA to approve all changes to the directory. (pp. 23-25/GAO Draft Report)

DOD RESPONSE: Concur. As discussed in the DoD response to Finding A, the Army changes to the Activity Address Code procedures have contributed significantly to better control of contractor access to the DoD supply system.

FINDING E: Actions To Improve Army Financial Accountability For GFM. The GAO reported that, since 1967, both it and the Congress have raised concerns about the financial accountability for GFM provided to contractors. According to the GAO, the DoD agreed that the Services should establish systems to adequately account for GFM by quantity and value, and should report the use of GFM by contractors. The GAO reported that, between 1981 and 1983, the DoD established general accounting principles and standards for GFM, and directed the Services to develop and implement appropriate accounting systems. The GAO found, however, that according to the DoD FY 1986 report prepared under the requirements of the Federal Managers' Financial Integrity Act, none of the Services had met this requirement. The GAO concluded, therefore, that the Army does not have an independent means to identify how much GFM is in the hands of its contractors, how much is being provided annually, and how it is being used. The GAO acknowledged that the Army has recognized that a better financial accounting system for GFM is needed, and that it should be integrated with the MCA concept and the AMC material requisitioning system. The GAO noted that an Army project to do so is underway, and is targeted for implementation by September 1988. The GAO endorsed the Army effort to implement a GFM financial accounting system, but expressed concern about the uncertainty of the implementation date. The GAO concluded that the Army uncertainties over GFM will not be corrected until the MCAs become operational and the reports are initiated. (pp. 25-28/GAO Draft Report)

Now on pp. 19-20.

DOD RESPONSE: Concur. The AMC has developed a financial accounting system for GFM that will identify how much GFM is in the hands of its contractors, how much is being provided annually, and how much has been used. This financial accountability system will be implemented in June 1989, as an integral part of the AMC implementation of the MCA concept.

The AMC has identified contractor access to GFM as an internal control weakness since FY 1985, and contractor access to GFM will be considered in connection with future assurance statements.

The exact method of accounting for GFM at retail installations will be determined after review of the LEA study on implementing

Appendix II
Letter From the Deputy Assistant Secretary
of Defense (Systems)

DoD Instruction 4140.48. The conceptual approach and milestones for implementing the accounting system for GFM at the retail level will be completed during the third quarter of FY 1988.

RECOMMENDATION

RECOMMENDATION:

The GAO recommended that, since over six years have passed since the DoD required better controls over contractor access to the DoD supply system, the Secretary of the Army should give priority to developing a plan of action, with firm milestones, for implementing the needed controls. (p. 3, p. 28/GAO Draft Report)

DOD RESPONSE: Concur. The Army is giving priority to developing a plan of action with milestones for implementing controls over contractor access to the DoD supply system. Milestones will be incorporated into the March 1988 update of the Army Supply Master Plan.

The Army implementation is proceeding on a two-track course-- implementation at the wholesale level and implementation at the retail level. Implementation at the wholesale level was scheduled to be completed in May 1988. This target date has slipped and all necessary System Change Requests (SCRs) will be in place by June 1989. This revised implementation date is, however, contingent upon promulgation and acceptance of DoD Military Standard Requisitioning and Issue Procedures by May 1988.

As indicated in the DoD responses to Findings B and E, the Army is currently studying the feasibility of implementing retail-level controls over contractor access to the DoD supply system. The conceptual approach and milestones for implementing retail controls will be completed during the third quarter of FY 1988.

Now on pp. 3-4.
See p. 21.

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